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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
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In the Matter of )

Extension Of Section 272 Obligations )  
Of Verizon In The State Of Massachusetts )  
\_\_\_\_\_ )

WC Docket No

02  
2-112

PETITION OF AT&T CORP.

Leonard J. Cali  
Lawrence J. Lafaro  
Aryeh S. Friedman  
AT&T Corp.  
One AT&T Way  
Bedminster, New Jersey 09721  
(908) 532-1831

*Counsel for AT&T Corp*

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## GLOSSARY OF COMMISSION ORDERS

SHORT CITE	FULL CITE
<i>Accounting Safeguards Order</i>	First Report and Order, <i>Implementation of the Telecommunications Act of 1996 Accounting Safeguards</i> , 11 FCC Rcd. 17539 (1996)
<i>Bell Atlantic-GTE Merger Order</i>	Memorandum Opinion And Order, <i>Application Of GTE Corp , Transferor, And Bell Atlantic Corp , Transferee, For Consent To Transfer Control</i> , 15 FCC Rcd. 14032 (2000)
<i>Bell Atlantic-NYNEX Merger Order</i>	Memorandum Opinion and Order, <i>In re NYNEX Corp , and Bell Atlantic Corp , for Consent to Transfer Control of NYNEX Corp , and its Subsidiaries</i> , 12 FCC Rcd. 19985 (1997)
<i>LEC Classification Order</i>	Second Report and Order, <i>Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area</i> , 12 FCC Rcd. 15756 (1997)
<i>Non-Accounting Safeguards Order</i>	First Report and Order and Further Notice of Proposed Rulemaking, <i>Implementation of Non Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended</i> , 11 FCC Rcd. 21905 (1996)
<i>New York Sunset Public Notice</i>	<i>Public Notice</i> , 17 FCC Rcd. 26864 (2002)
<i>Non-Dominance FNPRM</i>	Further Notice of Proposed Rulemaking proceeding in FCC WC Docket No. 02-112 and CC Docket No. 00-175, FCC 03-111 (rel May 19, 2003)
<i>Operate Independently NPRM</i>	Public Notice, <i>In the Matter of Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates</i> , WC Docket No. 03-228, DA-03-3742, (rel. Nov. 21, 2003)
<i>Texas Section 272 Extension Petition</i>	<i>Extension Of Section 272 Obligations Of Southwestern Bell Telephone Co In The State Of Texas</i> , WC Docket No. 02-112, <i>Public Notice</i> , 18 FCC Rcd. 13566 (2003)
<i>Triennial Review Order</i>	Memorandum Opinion and Order, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket Nos. 01-338 and 96-98, 18 FCC Rcd 16978 (2003)
<i>Verizon Massachusetts Section 271 Order</i>	Memorandum Opinion and Order, <i>Application of Verizon New England Inc , Bell Atlantic Communications, Inc (d/b/a Verizon Long Distance), NYNEX Long Distance</i>

SHORT CITE	FULL CITE
	<i>Company (d/b/a Verizon Enterprise Solutions) And Verizon Global Networks Inc , for Authorization to Provide In-Region, InterLATA Services in Massachusetts, CC Docket 01-9, 16 FCC Rcd 8988 (2001)</i>
<i>Verizon OI&amp;M</i>	<i>Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53 203(a)(2) of the Commission's Rules, CC Docket No. 96-149</i>
<i>UNE Remand Order</i>	<i>Third Report and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 15 FCC Rcd. 3696 (1999)</i>
<i>272 Sunset Notice</i>	<i>Notice of Proposed Rulemaking, Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, WC Docket No 02-112 (rel. May 24, 2002)</i>
<i>272 Sunset Order</i>	<i>Memorandum Opinion and Order, Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, WC Docket No 02-112 (Dec. 23, 2002)</i>

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**PETITION OF AT&T CORP.**

AT&T Corp ("AT&T") respectfully submits this Petition and requests that the Commission extend application of the separate affiliate and other safeguards of 47 U.S.C. § 272 to Verizon in Massachusetts for an additional three years

**INTRODUCTION AND SUMMARY**

On April 16, 2004, it will have been three years since Verizon's Massachusetts local market was deemed "open" to competition and Verizon was authorized to provide interLATA service in that state. Verizon, which controls over 50% of the residential long distance traffic in Massachusetts, has flourished under this new regime; local competition has not. CLEC share of the local market, primarily non-facilities based competition was, as of June 30, 2003, only 19%. With Verizon reporting that UNE-P net additions have been declining since the second quarter, the CLEC share of the local market has similarly declined during that period. Verizon's Second Section 272 Biennial Audit Report<sup>1</sup> demonstrates that in Massachusetts Verizon has persistently provided its long distance rivals with network access that is manifestly inferior to the access it

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<sup>1</sup> Report of PricewaterhouseCoopers LLP In Connection With The Second Biennial Section 272 Audit Of The Verizon Companies, EB Docket No. 03-200 (December 12, 2003) ("Verizon's Second Section 272 Biennial Audit Report").

provides to its own long distance affiliate. Moreover, Verizon has persistently discriminated between special access services provided by Verizon “to itself”, *i e* , special access services that the BOC has provided directly to “retail” customers, as compared to that provided to unaffiliated carriers on a wholesale basis

Accordingly, AT&T requests that the Commission exercise its authority under section 272(f) of the Communications Act, 47 U.S.C § 272(f), and find that Verizon’s enduring local market power in Massachusetts and its record of discriminatory practices and misallocation of costs in that state require the continuation of the “crucial[ly] importan[t]”<sup>2</sup> separate affiliate and other obligations that Congress and the Commission have recognized remain necessary in a state so long as the Bell operating company (“BOC”) retains substantial market power<sup>3</sup> To do otherwise would be an abdication of the Commission’s duty to protect competition and consumers.

## ARGUMENT

### **I. CONGRESS INTENDED THAT THE SECTION 272 SAFEGUARDS BE EXTENDED BEYOND THE INITIAL THREE YEAR PERIOD IF, AS HERE, LOCAL COMPETITION IS NOT SUFFICIENTLY ROBUST TO COUNTER THE BOC’S INCENTIVES AND ABILITY TO DISCRIMINATE AND MISALLOCATE COST.**

Section 272 was enacted to address the problem created by the fact that the BOCs were permitted to provide in-region long distance services under section 271 merely by *opening* their

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<sup>2</sup> *Verizon Massachusetts Section 271 Order* ¶ 226.

<sup>3</sup> AT&T has appealed both the Commission’s decision to allow Section 272 to sunset in New York, *Public Notice*, 17 FCC Rcd. 26864 (2002) and the Commission’s decision to allow Section 272 to sunset in Texas *Public Notice*, 18 FCC Rcd 13566 (2003) to the D.C. Circuit Court of Appeals (Nos. 03-1035 and 03-1258 respectively). The New York appeal is currently pending. Pursuant to a request from the Commission, AT&T has agreed to hold the Texas appeal in abeyance pending the Court’s review in the New York proceeding.

local markets. Section 272 thus reflects Congress' recognition that, even after a BOC is permitted to provide in-region interLATA service in a state, it will continue to have substantial market power in the provision of local services.<sup>4</sup> Section 272 targets the core concern that the BOC will leverage this local market power both to undermine existing competition in the long-distance market and to stifle fledgling competition in those local markets. In particular, these section 272 safeguards are designed to deter and detect BOC discrimination against interLATA competitors and in favor of their own long-distance affiliates and BOC subsidization of those long-distance affiliates by recovering the affiliates' costs from local and exchange access customers<sup>5</sup>

Because Congress could not know in advance how long it would take actual price-constraining competition to develop in a particular state after local markets were finally opened to competition – competition that would eliminate the BOC's ability and incentive to leverage anticompetitively its local network facilities – it provided that section 272 would apply for a

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<sup>4</sup> *Non-Accounting Safeguards Order* ¶ 9 (“In enacting section 272, Congress recognized that the local exchange market will not be fully competitive immediately upon its opening”).

<sup>5</sup> *Id.* Verizon has claimed that fears of cost misallocation and cross-subsidization are misplaced because the BOCs today operate under a “pure price cap regime.” Verizon 272 Sunset Comments at 18, WC Docket No. 02-112 (filed Aug. 5, 2002) (“Verizon’s 272 Sunset Comments”). However, as AT&T has shown in detail, BOCs still retain incentives and ability to misallocate costs under price cap regulation. AT&T 272 Sunset Reply Comments, Selwyn Reply Dec. (Aug. 26, 2002) ¶¶ 30-37; Letter from David L. Lawson, on behalf of AT&T, to Marlene Dortch, FCC, Verizon OI&M, Selwyn *Ex Parte* Dec. (Nov. 15, 2002) ¶¶ 44-45; AT&T’s Non-Dominance FNPRM Comments, Selwyn Dec. (June 30, 2003) ¶¶ 97-103; AT&T’s Reply Non-Dominance FNPRM Comments, Selwyn Reply Dec. (July 28, 2003) ¶¶ 57-58; AT&T’s Comments, Operate Independently NPRM, Selwyn Decl. (Dec. 10, 2003) ¶¶ 13-14. All are incorporated herein by reference. AT&T is also submitting all documents incorporated herein by reference as attachments to this Petition so that they are contained in the record in this proceeding. The risk of BOC discrimination and cost misallocation is, therefore, far more than a theoretical concern – it presents a real and substantial threat to the interexchange marketplace. *Bell Atlantic-GTE Merger Order* ¶¶ 195, 198

*minimum* of 3 years after a BOC received section 271 authority.<sup>6</sup> But Congress recognized the possibility that a BOC's market power might not dissipate that quickly, and it provided the Commission with authority to extend those requirements by rule or by order.<sup>7</sup> And it is for precisely these reasons that the Commission concluded in its initial orders implementing section 272 in 1996 that its section 272 rules would remain in place "until facilities-based alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary."<sup>8</sup>

Moreover, in its *Bell Atlantic – GTE Merger Order*, the Commission found that the combination of Bell Atlantic and GTE *heightened* the combined entity's "ability and incentive ... to discriminate" against independent long distance carriers and that this incentive is particularly acute with regards to advanced or customized access services.<sup>9</sup> Indeed, in that merger, the Commission rejected the claim that the existing regulatory regime was sufficient to detect and prevent discrimination by Verizon<sup>10</sup>

## **II. THE SECTION 272 SAFEGUARDS REMAIN CRITICALLY IMPORTANT IN MASSACHUSETTS.**

In light of the indisputably slow pace of local competition growth in Massachusetts, the section 272 safeguards remain as necessary today as they were when Verizon was first granted

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<sup>6</sup> 47 U.S.C. § 272(f)(1)

<sup>7</sup> *Id*

<sup>8</sup> *Non-Accounting Safeguards Order* ¶ 13, *see also* 272 *Sunset Notice* WC Docket No. 02-112 ¶ 12 (the Commission could "support the sunset of [section 272] statutory requirements" only if and only when competitive "circumstances [have] *changed* in three years") (emphasis added).

<sup>9</sup> *Bell Atlantic – GTE Merger Order* ¶¶ 173-174, 179, 183-185, 190.

<sup>10</sup> *Id* ¶¶ 179, 194



section 271 authority. Until local competition in Massachusetts is far more robust, Verizon will continue to have both the incentive and ability to discriminate in favor of its long distance affiliates and to leverage its dominance into downstream markets. Although the section 272 safeguards do not eliminate those problems – nothing less than full structural separation could accomplish that – they do provide an important regulatory tool for detecting and deterring such anticompetitive conduct

**A. There Is Insufficient Local Competition In Massachusetts To Allow Section 272 Safeguards To Sunset.**

**1. There Is No Meaningful Facilities-Based Competition In Massachusetts.**

As the Commission has recognized, the most relevant competition for purposes of determining whether section 272 obligations should sunset is *facilities-based* competition enabled by deploying alternative facilities.<sup>11</sup> This is because the BOC's ability anticompetitively to harm rivals is based on its control of the bottleneck network facilities that are necessary for the provision of interLATA services. Thus, regardless of competitive carriers' retail "market share," so long as competitive carriers remain dependent upon BOC facilities to provide services to customers, a BOC can raise its rivals' costs and restrict its rivals' output by denying and/or delaying access to essential network inputs and by engaging in cross-subsidization and price squeezes.<sup>12</sup> Indeed, this is true even when the competitive carrier uses its own facilities in

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<sup>11</sup> See *Non-Accounting Safeguards Order* ¶ 13 (section 272, and associated implementing rules and policies, would apply "until *facilities-based* alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary") (emphasis added).

<sup>12</sup> See *LEC Classification Order* ¶¶ 100, 158; *Non-Accounting Safeguards Order* ¶¶ 9-13; see also *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646, 1662 (2002) ("*Verizon*") (The carrier that controls the "local-loop plant" could "place conditions or fees . . . on long-distance carriers seeking to connect with its network")

connection with leasing BOC facilities. For example, even if a competitive carrier serves a customer using its own switch, it still must lease BOC-provided loops and the BOC has the incentive and ability to give that carrier an inferior quality loop, to slow-roll provisioning of the loop, and to charge supra-competitive prices for the loop. That is why the state commissions have argued that the Commission should require a showing of fully competitive markets and alternative sources of supply before considering the removal of section 272 safeguards.<sup>13</sup>

There are no significant facilities-based alternatives to Verizon's local exchange and access services in Massachusetts, and, as a result, the section 272 safeguards remain necessary in that state. Competitive carriers in Massachusetts remain highly dependent upon Verizon to provide local telephone services in that state, as well as to originate and terminate long distance and broadband services that they provide. Indeed, the most recent *FCC Local Competition Report* shows that over 96 percent of all switched access lines are served directly by ILECs or by CLECs using ILEC-provided facilities to compete through resale or UNE-based services.<sup>14</sup> And the Commission's own recently announced findings in the Triennial Review Proceeding explain why. self-deployment of key local network facilities is, in the vast majority of circumstances,

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<sup>13</sup> Texas PUC 272 Sunset Comments at 3, WC Docket No. 02-112, (filed July 25, 2002) ("Texas PUC 272 Sunset Comments") ("[P]rudence demands that the sunset period be extended *until the conditions which necessitated the creation of competitive safeguards no longer exist*") (emphasis added); *see also* Washington UTC 272 Sunset Comments at 2, WC Docket No. 02-112 (filed Aug. 5, 2002) ("Washington UTC 272 Sunset Comments") (Commission should not "lift[] the safeguards too soon," *i.e.*, before "robust, sustainable competition . . . develop[s]"); Missouri PSC 272 Sunset Comments at 3, 4, WC Docket No. 02-112 (filed Aug. 5, 2002) ("Missouri PSC 272 Sunset Comments") (retain safeguards "until such time as the BOC no longer has an incentive and the ability to discriminate against long distance competitors or to engage in other anti-competitive conduct").

<sup>14</sup> FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition Status as of June 30, 2003* (rel. Dec. 22, 2003) ("*December 2003 FCC Local Competition Report*") Tables 1, 3 & 4. In fact, the number of CLEC owned lines actually declined since the last FCC Report. *Id.* Table 3.

uneconomic because of enormous entry barriers.<sup>15</sup> As the Supreme Court explained, “[i]t is easy to see why a company that owns a local exchange . . . would have an almost insurmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the market[] for . . . long-distance calling as well.”<sup>16</sup>

**2. Even Considering Non-Facilities-Based Competitors, Verizon Faces Insufficient Retail Competition In Massachusetts To Allow Section 272 To Sunset.**

Verizon’s overwhelming market power in Massachusetts is clear even if one includes non-facilities-based competition. The most recent *FCC Local Competition Report* shows that total CLEC market share in Massachusetts was only 19% as of the end of June, 2003.<sup>17</sup> And that share has declined since that time, indeed, Verizon, in its January 29, 2004 investor briefing, reported that in the most recent two quarters it has *reversed* the rate of UNE-P net additions.<sup>18</sup> In stark contrast, Verizon in that same presentation announced that it has 52% of the residential interLATA long distance market share in Massachusetts – a phenomenal result in less than three years after entry that highlights Verizon’s enduring market power in local markets.<sup>19</sup>

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<sup>15</sup> See e.g., News Release, *FCC Adopts New Rules For Network Unbundling Obligations Of Incumbent Local Phone Carriers* (Feb. 20, 2003); *Triennial Review Order* ¶¶ 225-226, 298; *UNE Remand Order* ¶ 182 (“self-provisioning is not a viable alternative because replicat[ion of] an incumbent’s vast and ubiquitous network would be prohibitively expensive and delay competitive entry”).

<sup>16</sup> *Verizon* at 1662.

<sup>17</sup> *December 2003 FCC Local Competition Report* at Table 7.

<sup>18</sup> <http://investor.verizon.com/news/20040129/20040129-2.pdf> (“Verizon 4<sup>th</sup> Quarter & Full Year 2003 Financial Results,” Doreen Toben) at 16.

<sup>19</sup> <http://investor.verizon.com/news/20040129/20040129-4.pdf> (Lawrence T. Babbio Jr. presentation) at 6. Reporting on the region as a whole, Verizon reported that it had an “in-region market penetration of 41 percent” and that “48 percent of Verizon residential customers have purchased local services in combination with either Verizon long distance or Verizon DSL or

(continued . . .)

In short, there is overwhelming real world evidence that Verizon's local market power has not been significantly reduced, even three years after it won approval pursuant to section 271 to offer in-region, interLATA services. Until Verizon's market power has dissipated, the reasons for each of the section 272 requirements remain, and no rational basis exists for finding that either the public interest or competition will be served by their elimination.

**B. Because Verizon Continues To Misallocate Costs And To Discriminate Against Unaffiliated InterLATA Competitors In Massachusetts, The Section 272 Safeguards Must Be Extended.**

Allowing the section 272 safeguards to "sunset" in the face of these facts would be profoundly anticompetitive and contrary to the public interest. So long as Verizon enjoys substantial local market power, it will have the ability to act on its clear incentives to discriminate and cross-subsidize in favor of its long distance operations. This is not mere speculation. It is confirmed by the second biennial section 272 audit of Verizon's Massachusetts operations, and by evidence in other proceedings that Verizon has discriminated in the provision of special access in favor of its retail customers and against unaffiliated carriers who purchase the identical special access out of wholesale.

**1. The Second Section 272 Audit Shows Discrimination And Cost Misallocation in Massachusetts.**

The second section 272 biennial audit of Verizon, despite being improperly narrow,<sup>20</sup> shows that Verizon has engaged in substantial discrimination and cross-subsidization in

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( . . . continued)

both." <http://investor.verizon.com/financial/quarterly/VZ/4Q2003/4Q03Bulletin.pdf> (Verizon Investor Quarterly, January 29, 2004) at 2 and 4

<sup>20</sup> See Comments Of AT&T Corp. On Verizon's Section 272 Compliance Biennial Audit Report, EB Docket No. 03-200 (Feb. 10, 2004) ("AT&T's Second Verizon Biennial Audit Comments") at 2-3 and 6-7. AT&T hereby incorporates those comments herein.

Massachusetts notwithstanding the limits and transparency imposed by the section 272 safeguards. Absent such safeguards, this anticompetitive conduct would only escalate.

The performance data show that Verizon's affiliates consistently received better performance. As explained in the Declaration of statistician Dr. Robert Bell attached to AT&T's Comments on that audit, the average Firm Order Confirmation Response Time ("FOC") intervals in Massachusetts for non-affiliated carriers for DS-1 service were consistently and materially longer than for the 272 affiliate Bell Decl. ¶ 6. In 2001, for example, the average FOC interval for non-affiliates was 7.9 days, while it was only 2.0 days for section 272 affiliates.<sup>21</sup> Results for "Average Installation Interval" for DS-1 service in Massachusetts followed a similar pattern. In 2001, the non-affiliates' average was more than twice that for affiliates; in 2002, the averages were 24.8 days for non-affiliates and 18.7 days for affiliates.<sup>22</sup>

Non-affiliates similarly received poorer repair service in Massachusetts than the section 272 affiliates. For FG-D in Massachusetts, non-affiliates consistently had repair times in 2002 that were more than twice that for section 272 affiliates.<sup>23</sup> The auditor's report also disclosed that the BOC's sales representatives failed to inform new customers of their long distance options on 9% of the calls, with 1% meeting the criteria of "steering" the customer to the section 272 affiliate.<sup>24</sup>

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<sup>21</sup> AT&T's Second Verizon Biennial Audit Comments, Bell Decl. ¶ 7

<sup>22</sup> *Id.* Bell Decl. ¶ 8

<sup>23</sup> No data were reported for this product in 2001. Indeed, these data may well understate the true differential inasmuch as Verizon excluded "trouble" data that should have been included under the business rules Verizon used. *Id.* Bell Decl. ¶ 10

<sup>24</sup> AT&T's Second Verizon Biennial Audit Comments at 10-11. The "steered" customer was told that "[i]f you choose Verizon, there is no extra charge, but if you choose another carrier, there is a one-time fee of \$5.00." There is no such fee. The auditor's Report likewise details numerous  
(continued . . .)

## **2. Evidence From The Other Proceedings Shows That Verizon Has Engaged In Discriminatory Conduct.**

The first section 272 audit of Verizon showed that it discriminated in the provisioning of special access<sup>25</sup> and engaged in cost misallocation.<sup>26</sup> As a result, the Commission issued a Notice of Apparent Liability finding that “Verizon failed to record a total of 43 transactions [out of 70 sampled] according to the methods specified in section 32.27” and that “Verizon has apparently failed to justify its accounting entries for approximately \$16 million in services provided to its section 272 affiliate.”<sup>27</sup> The Commission also found numerous web posting violations.

AT&T’s Comments in the *Section 272 Sunset Proceeding* identified other instances of discriminatory conduct, including manipulation of the PIC freeze process.<sup>28</sup> The record in the *Non-Dominance NPRM Proceeding* demonstrated that Verizon’s offerings in Massachusetts and elsewhere created price squeezes.<sup>29</sup> Finally, AT&T demonstrated to the Massachusetts

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violations by Verizon of its Section 272 obligations to, *inter alia*, comply with the affiliate transaction rules *Id.* 20-28.

<sup>25</sup> See AT&T’s First Verizon Biennial Audit Comments, CC Docket No. 96-150 (April 8, 2002) at 16-22 (provisioning of special access)

<sup>26</sup> *Id.* at 31-35 AT&T’s Comments, Operate Independently NPRM, Selwyn Decl. (Dec. 10, 2003) ¶ 25

<sup>27</sup> *In the Matter of Verizon Telephone Companies, Inc Apparent Liability for Forfeiture*, File No. EB-03-IH-0245 (rel. Sept. 8, 2003), ¶¶ 13-17

<sup>28</sup> WC Docket No. 02-112. See AT&T 272 Sunset Comments at 24-30 and 32.

<sup>29</sup> AT&T’s Non-Dominance FNPRM Comments (filed June 30, 2003), Selwyn Dec. ¶¶ 45-48 (Dr. Selwyn, analyzing the Verizon’s Variations Freedom (sm) plan offered in Massachusetts -- see Attachment 2 -- concluded that the average price per minute for interstate and intrastate calling combined was below the intrastate switched access rates), 71 (“Metropolitan Service” offered in the greater Boston area where toll routes are incorporated into the subscriber’s unlimited calling area; in other parts of the state the “Circle Calling Service” converts toll routes within a roughly 20 mile radius to local rate treatment), and 89, note 111 (Verizon offers “Massachusetts residential customers a flat rated LATA-wide unlimited calling plan as well as  
(continued . . .)

Department of Telecommunications and Energy (DTE) how Verizon has discriminated in favor of its retail customers for special access services and against unaffiliated carrier wholesale customers.<sup>30</sup>

The evidence from these proceedings demonstrates that Verizon has engaged in a disturbing and persistent pattern of discrimination and cross-subsidization aimed at harming its rivals. As shown below, elimination of the section 272 safeguards would substantially lessen the Commission's ability to detect and deter that misconduct.

### **3. Continuation Of The Section 272 Safeguards Are Essential**

Section 272 can play a significant role in detecting whether such anticompetitive conduct is occurring.<sup>31</sup> For example, the requirement that the BOC maintain a separate affiliate and maintain separate books and records in accordance with GAAP significantly improves the ability of regulators and competitors to detect price squeezes.<sup>32</sup> The requirement that BOCs post summaries of their affiliate transactions gives regulators and competitors information that is relevant in determining whether a BOC affiliate is being charged an appropriate rate for the goods or services it obtains from the BOC, and how the affiliate's costs are aligned with the rates

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( continued)

optional extended calling plans to provide flat-rate calling to points that would otherwise be subject to toll charges”).

<sup>30</sup> Investigation by the Department of Telecommunications and Energy on its own motion pursuant to G.L. c. 159, §§ 12 and 16, into Verizon New England Inc., d/b/a Verizon Massachusetts' provision of Special Access Services, DTE 01-34, Surrebuttal testimony of Eileen Halloran (April 3, 2002) appended hereto as Attachment 1.

<sup>31</sup> As AT&T has explained, the protections of section 272 are unique and other regulatory protections, such as existing ARMIS regulations and equal access obligations, are not sufficient to detect and prevent discrimination and cost-shifting. AT&T 272 Sunset Reply Comments at 20-22, *see also* Washington UTC 272 Sunset Comments at 3 (section 272 safeguards “provide necessary consumer and competitive protections that cannot otherwise be obtained”).

<sup>32</sup> *Accounting Safeguards Order* ¶ 9

the affiliate is charging others. The requirements that the BOC maintain a separate affiliate and deal with that affiliate on an arm's length basis are essential for determining whether Verizon is discriminating against rivals. Similarly, both state regulators<sup>33</sup> and the Commission have stressed the importance of biennial audits to provide "*stringent* post-entry oversight" and a "*thorough and systematic* evaluation" of a BOC's treatment of competitors.<sup>34</sup> Indeed, the Commission has found such audits to be "critical" to local competition:

Commission guidance of the audit process is crucial to assuring that the accounting and structural safeguards are in place and functioning properly. Because of the critical nature of accounting safeguards in promoting competition in the telecommunications market and the *critical role* the biennial audit will play in ensuring that the safeguards are working, it is essential that we establish effective biennial audit rules at the outset.<sup>35</sup>

And, as Commissioner Martin has observed, it is, to say the least, "odd" for the Commission to sunset section 272 obligations before the sufficiency of the biennial audit process has been established and it is fully known the extent to which the BOCs have, in fact, been discriminating and cost-shifting.<sup>36</sup>

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<sup>33</sup> The Missouri PSC reports that "without the section 272 audit process, there is no way to detect and deter discrimination and anti-competitive behavior." Missouri PSC 272 Sunset Comments at 4, *see* Washington UTC 272 Sunset Comments at 3 ("maintaining a separate affiliate makes the audit process easier and provides more transparency to the transactions to be audited"); Pennsylvania PUC 272 Sunset Comments at 4, WC Docket No. 02-112 (filed July 22, 2002) ("Pennsylvania PUC 272 Sunset Comments") ("audits can produce useful information for policymakers such as the PUC")

<sup>34</sup> *Bell Atlantic-NYNEX Merger Order* ¶ 416 & n.1284 (emphasis added).

<sup>35</sup> *See Accounting Safeguards Order* ¶ 197 (emphases added).

<sup>36</sup> *272 Sunset Order*, Martin Statement at 1. *See also* Texas PUC SBC Biennial Audit Comments at 9 ("The better course would be for the FCC to require compliance with the audit requirements of Section 272 before considering whether to remove a BOC's Section 272 affiliate obligations")



### **III. THE BENEFITS OF EXTENDING THE SECTION 272 SAFEGUARDS CLEARLY OUTWEIGH ANY COSTS THAT THEY MAY IMPOSE.**

Neither Verizon nor any other BOC has ever substantiated their claims that compliance with the section 272 safeguards is particularly costly, much less that those costs outweigh the clear public interest benefits of maintaining the safeguards. The declarations that Verizon submitted in the *Ol&M Forbearance* and the *Operate Independently NPRM* proceedings were little more than conclusory statements that opine generally about costs, without any specific discussion of how those costs were derived and without any backup material that could be used to verify independently these claims.<sup>37</sup> Verizon has had several opportunities to provide hard evidence to support its claims, most recently in response to a request by AT&T in the *Operate Independently NPRM* proceeding<sup>38</sup> and Verizon's repeated failure to do so, even under a Protective Order, can only be interpreted as meaning that Verizon lacks such evidence.

Moreover, Verizon's claims that the section 272 structural safeguards have, and will, cost it hundreds of millions of dollars during the period in which section 272 applies to its operations,<sup>39</sup> is undercut by the admission of the other BOCs that the costs are nowhere near that high. BellSouth, for example, submitted evidence showing that the cost of compliance with the section 272 safeguards is only about 9 cents per month for each of BellSouth's customers. This tiny amount explains fully why the BOCs, including Verizon, have been able to compete in – and

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<sup>37</sup> See *Ex parte* Letter from David Lawson, on behalf of AT&T, to Marlene Dortch, FCC, CC Docket No. 96-149 (Nov. 15, 2002), Letter from C. Frederick Beckner, on behalf of AT&T, to Marlene Dortch, Secretary, Federal Communications Commission, July 9, 2003

<sup>38</sup> *Ex parte* Letter from Aryeh Friedman, AT&T, to Marlene Dortch, FCC, WC Docket No. 03-228 (Jan. 29, 2004).

<sup>39</sup> Letter from Kathryn C. Brown, Senior Vice President, Verizon, to Commissioner Jonathan S. Adelstein, October 31, 2003 at 2 (\$183 million from 2003 through 2006).

in some cases dominate – the long distance markets without the slightest competitive handicap imposed by the section 272 safeguards. Verizon’s absurd assertions that it incurs hundreds of millions of dollars in costs are thus not at all caused by the section 272 safeguards, but rather is: (1) made out of “whole cloth;” (2) if not “whole cloth,” then the result of gigantic errors in Verizon’s methodology for accounting for such costs (which Verizon has never adequately disclosed), or (3) the result of Verizon’s own choices regarding how to structure its long distance operations -- which, if their figures are correct, simply demonstrate that Verizon has made grossly inefficient decisions relative to the other BOCs.

The BOCs’ claims that section 272 safeguards prevent them from taking advantage of important economies of integration are particularly disingenuous. The Commission’s orders implementing section 272 already have provided numerous opportunities for the BOCs and their section 272 affiliates to share services and take advantage of other economies.<sup>40</sup> Even though these joint activities present risks of anticompetitive behavior, and could easily have been prohibited entirely, the Commission permitted such activities, which substantially reduced the BOCs’ costs of compliance with section 272.<sup>41</sup>

The Commission’s orders approving Verizon mergers with separate affiliate conditions found that the separate affiliate requirement was an effective way to “ensure a level playing

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<sup>40</sup> See, e.g., WorldCom 272 Sunset Comments at 7-9, WC Docket No. 02-112 (filed Aug. 5, 2002) (“WorldCom 272 Sunset Comments”); Time Warner 272 Sunset Comments at 17-20, WC Docket No. 02-112 (filed Aug. 5, 2002) (“Time Warner 272 Sunset Comments”).

<sup>41</sup> The Commission has also largely eliminated restrictions on bundling, even for dominant carriers like Verizon. See generally *Bundling Order*. Thus, Verizon and the other BOCs today offer customers a broad array of bundled offerings, including combinations of local, long distance, data and wireless. <http://investor.verizon.com/news/20040129/20040129-4.pdf> (Lawrence T. Babbio Jr. presentation) at 4-5; AT&T’s Non-Dominance FNPRM Comments (filed June 30, 2003), Selwyn Dec. ¶¶ 39-40, 45-49, 71, 84-86.

field” between a BOC and its rivals.<sup>42</sup> These orders therefore reflect the Commission’s determination that separate affiliate structures can be a cost-effective method for preventing discrimination and otherwise policing BOC misconduct. As discussed above, section 272, when properly implemented and vigorously enforced, provides substantial and unique benefits that promote competition in telecommunications markets. As state regulators have explained, if section 272 safeguards are eliminated, they “will lose a valuable means to ensure [the BOC’s] compliance with its obligations to provide access to the local exchange and exchange access markets that [the BOC] controls.”<sup>43</sup>

Eliminating section 272 requirements would also be contrary to Congress’ clear purpose in enacting section 272. Given that most of the rules that the BOCs have cited as obviating the need for section 272 were in effect in 1996, Congress necessarily believed that additional protections were necessary because existing rules would not be effective in policing the BOCs’ misconduct and eliminating discrimination and cost misallocation.

Whatever “burdens” that section 272 imposes on Verizon, one thing is clear: existing section 272 obligations did not prevent Verizon from quickly becoming the dominant long distance provider in its local territories. Indeed, Verizon’s experience only confirms the need to strengthen, rather than abandon, existing protections against discrimination and cross-subsidization. In the absence of section 272 safeguards, Verizon would have even greater ability to exclude competitors and raise their costs.

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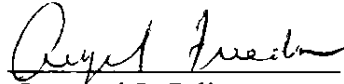
<sup>42</sup> *Bell Atlantic-GTE Merger Order* ¶ 260 (“strict compliance” with a “separate affiliate condition will mitigate the substantial risk of discrimination”).

<sup>43</sup> Texas PUC 272 Sunset Comments at 3; *see also* Pennsylvania PUC 272 Sunset Comments at 5; Missouri PSC 272 Sunset Comments at 3, 4; Washington UTC 272 Sunset Comments at 2.

## CONCLUSION

For the foregoing reasons, the Commission should issue a rule extending application of section 272 to Verizon in Massachusetts for an additional three years

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Aryeh S. Friedman", written over a horizontal line.

Leonard J. Cali  
Lawrence J. Lafaro  
Aryeh S. Friedman  
AT&T Corp.  
One AT&T Way  
Bedminster, New Jersey 09721  
(908) 532-1831

*Counsel for AT&T Corp*

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